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IN THE COURT OF CHANCERY OF
THE STATE OF DELAWARE
IN AND FOR NEW CASTLE COUNTY

AMBASE CORPORATION, a Delaware corporation, Plaintiff, vs. CITY INVESTING COMPANY LIQUIDATING TRUST, as Successor to CITY INVESTING COMPANY, a dissolved Delaware corporation, et al., Defendants.	Civil Action No. 18207

Chancery Courtroom No. 1
Herrmann Courthouse
Wilmington, Delaware
Thursday, December 14, 2002

BEFORE: HON. LEO E. STRINE, JR., Vice Chancellor.

RULING OF THE COURT ON DEFENDANTS' MOTION TO DISMISS

CHANCERY COURT REPORTERS
135 Herrmann Courthouse
Wilmington, Delaware 19801
(302) 577-2447

THE COURT: Thank you very much.

While I don't ordinarily do this, in this case I am convinced with respect to at least one thing, and I don't feel

myself to be really plowing any new ground here in dealing with this. Putting aside the merits, I think I am not convinced – I certainly would need to think about it longer – that there isn't more than one plausible reading of the contract. What I am convinced of, based on the record, is that AmBase should have brought this claim a long time ago and that it is out of time.

This is a court of equity. We don't blindly follow a statute of limitations, but we do usually follow it unless there is some reason why we shouldn't. I don't see any reason here not to follow it.

This is not a case of sort of secondary indemnification, where someone has a contract in which they are primarily liable and they know that some other corporation or some other source is secondarily liable and where there is no expectation that the party that is secondarily liable will be anything until a liability really arises. That is not this kind of case. This wasn't a situation where AmBase was expected to defend this for 20-some odd years and then be able to just turn around at the time of a judgment and say to the liquidating trust, "Now you pay the judgment."

This is a situation where one entity divided itself, and it allocated liabilities and assets. AmBase became the agent with the Internal Revenue Service for certain tax liabilities of City Investing Company. It only became liable under the contract for things within the scope of that agency.

I believe in this circumstance if AmBase believed that it was being subjected to liability, the potential for liability and for costs in defending a claim which was not within the scope of that agency, that it could have immediately sued the trust and said, "This is not our liability. We don't have a contract with you to assume this liability, and unless you come up and come clean with the IRS, then you are essentially committing

a fraud or a tort, because we weren't the ones. We did not take this from you. We don't understand how we got this lemon. This is not what we bargained for." I think that kind of suit could have been brought in 1986, because here AmBase is simply saying we didn't have any part in this.

Now, there is this secondary part where they say, you know, if the trust itself can't handle anything, we are kind of the cleanup guarantor. But that is not what this case is about. This case is about saying, "This primary liability was never contractually shifted from City Investing Company to AmBase. It never was there in the first place. We shouldn't be dealing with this. It is not within the scope of the agency that we took on."

And I think it is proven that the case could have been brought by the fact that the case now seeks defense costs back to 1986 and saying that these should not have been borne by AmBase because AmBase should not have been in this position because this was not within the scope of the tax claims which AmBase contractually agreed to take from City Investing Company. Giving AmBase all of its due, the claim began to run at least as early as the notice of deficiency, because if you don't act on the notice of deficiency by challenging it, it is going to be reduced to a judgment. All along this has been a sum certain, and interest has been running.

I don't believe – and if it were the only issue, I would be tempted to give the plaintiffs leave to replead. If the only thing that this was turning on was the notion that some of the trustees overlapped, I might give the plaintiffs leave to replead and deal with that issue. But Mr. Collins has very candidly admitted that he doesn't even think that the overlapping trustees consisted of a majority of the AmBase board.

I am not at all convinced that they had the sort of conflict that our law would say disabled them from acting on behalf of AmBase. Certainly nothing has been pled that would indicate that they had any improper personal motivation to disadvantage AmBase in order to benefit the liquidating trust. They seem to have a fairly important stake in each entity.

But putting that aside, the fact is that by the facts pled in the complaint itself, no trustees were left on the board of AmBase by I think the end of 1995. By the end of 1996 Mr. Mantell was gone as an officer, and so this cloud that supposedly kept this corporate entity from discovering a claim that was based on a contract that was out there in the open, clearly there was no disability on its part from beginning at that point to act. It didn't file in December '97, didn't file in December '98, didn't file in December '99. Didn't file until August 14 of 2000.

Plainly there was inquiry notice out there. All these documents were in the possession of the corporation itself. It was represented by an able New York law firm. It has officers. All they had to do was read their own agreement. And I just don't think – and I agree with the defendants here that under the borrowing statute, we would apply the shorter limitations, which would be the Delaware period. I think that is what the Petzer case did, and that is certainly, I think, the appropriate period to be looking at here, not saying under New York law. So I just don't understand how there really is anything that tolled the statute of limitations. As I said, I am inclined to think it began running much earlier than the 1990's, but clearly it began running by '95. And there has been no disability on the part of AmBase.

Alternatively, as the Petzer case did, the equitable doctrine of laches – it is a little unusual, I think, to apply that on the basis of a complaint, but I think the complaint itself

pleads facts which convince me that the defendants' resort to laches is appropriate and also merits dismissal.

The trust was essentially denied the opportunity that it should have had to control the destiny of the dealings with the IRS. Again, even assuming that there was some disability until the mid-1990's, still the trust wasn't given the opportunity to cut off interest at any point. I don't know what would have happened, but I don't think that that is the defendants' burden here. The fact is, because of AmBase's failure to raise this argument in a timely way, the trust never had the chance as a trust to pay this money. That may have made a lot of economic sense in the context of a trust, but it was denied that opportunity. It also didn't have a chance to direct the negotiations with the IRS.

We don't lightly disregard separate corporate entities in Delaware. And the fact that there was some overlapping directors doesn't mean that I can assume that the trust and AmBase would have been exactly the same entity under the law. An operating company and a liquidating trust may have very different objectives. There may be a very different bargaining strategy.

What is clear out of this is no one knows what the trust would have done, but we do know that the trust didn't have that choice. And I think the Porach case that Vice Chancellor Lamb wrote and even the Petzer case indicate that laches can be appropriately invoked when a party reasonably changes a position to their detriment and relies on another party's conduct. And here it was reasonable to assume for the trustees that this was being taken care of primarily by AmBase and for them to have planned their conduct accordingly. And it is pled in the complaint, in fact, that there have been substantial distributions out of the trust that have reduced the trust to less than the liability owed to the IRS.

So for all those reasons and the reasons I think very well stated by the defendants in their paper, I am convinced from the facts of the complaint and the documents attached to the complaint that the defendants' motion to dismiss on statute of limitations and laches grounds is meritorious, and I would sign an appropriate order that was submitted promptly by the defendants after approval as to form by the plaintiffs.

I want to thank everybody. I don't ordinarily rule from the bench, and it is not because it was such an easy case to come to that conclusion. The papers on both sides and the arguments were very clear and effective. But I am sufficiently convinced that it is the right result and that I am not really breaking any new ground, that at least this aspect of this matter will move along promptly.

So I will wait for an order from the defendants. Thank you.

- - -

(Court adjourned at 4:13 p.m.)

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

AMBASE CORPORATION, a Delaware corporation, Plaintiff, -against- CITY INVESTING COMPANY LIQUIDATING TRUST, as Successor to CITY INVESTING COMPANY, a dissolved Delaware corporation, and GEORGE T. SCHARFFENBERGER, EBEN W. PYNE and LESTER J. MANTELL, Individually and as Trustees of the CITY INVESTING COMPANY LIQUIDATING TRUST, Defendants.	01 Civ. 0771 (LLS)

MEMORANDUM IN SUPPORT OF MOTION TO DISMISS

Introduction

Defendant City Investing Company Liquidating Trust (the "Trust") respectfully submits this memorandum in support of its motion to dismiss the Complaint as to all defendants on the grounds of the statute of limitations and laches.[1] This action has already been dismissed on those grounds by the Delaware Chancery Court by bench opinion

[1] The Trust also moves to dismiss the breach of fiduciary claim set forth in Count III of the Complaint on the ground that it fails to state a valid cause of action under New York law.

on December 14, 2000 (Exhibit A); by final order dated January 3, 2001 (Exhibit B); and by opinion dated February 7, 2001, denying AmBase's motion for reargument (Exhibit C; hereinafter referred to as "Strine Op."). All Exhibits are attached to the affidavit of Paul M. Dodyk dated February 22, 2001.

Statement of Facts[2]

This case arises out of an Assignment and Assumption Agreement between plaintiff AmBase Corporation (then known as the Home Group, Inc.) ("AmBase") and City Investing Company ("City") dated August 30, 1985 (the "Assignment Agreement"). (Exhibit D.)

AmBase was at that time a wholly owned subsidiary of City and the parent of The Home Insurance Company. (Strine Op. 2-3.) The Assignment Agreement was entered into by City and AmBase incident to the stockholder-approved liquidation of City in September 1985 to assume the liability for the future payment by AmBase of certain tax and other liabilities so that City could proceed with its liquidating distributions to City stockholders. The Assignment Agreement also allowed AmBase to improve its balance sheet by eliminating a substantial debt owed by AmBase to its parent, City. Under the Assignment Agreement, AmBase assumed "all obligations of City for Federal income taxes (including interest and penalties thereon) as common parent of the City Affiliated Group.

* * *

[2] The statement of facts in this memorandum is largely drawn from the Complaint and Vice Chancellor Strine's opinion, attached as Exhibit C.

In addition, AmBase has attempted to mislead the Court into excusing its tardiness by alleging its exclusive reliance upon individual defendants and concealing the existence of an opinion from Willkie, Farr & Gallagher which AmBase sought and which advised that AmBase could not avoid its liability under the Assignment Agreement. (Exhibit H.)

The Trust, its Trustees, and its unitholders have already had to bear the burdens of twice defending against AmBase's unfounded claims, once in securing their dismissal in Delaware and, secondly, in opposing AmBase's ill-considered motion for reargument. Any competent practitioner, with a copy of the C.P.L.R. and a modicum of effort, could have easily ascertained that this action cannot be pursued in New York in good faith.

If the Court deems Rule 11 sanctions appropriate, the Trust will make the necessary application to recover all of the fees and expenses that it has and will sustain in defending this action, together with any additional deterrent sanction the Court deems appropriate in the circumstances.

ARGUMENT

I. AMBASE'S BREACH OF CONTRACT CLAIM IS BARRED BY THE NEW YORK STATUTE OF LIMITATIONS CONTAINED IN C.P.L.R. § 213(2)

C.P.L.R. § 213(2), applicable to "an action upon a contractual obligation or liability, express or implied", governs AmBase's claims arising from the Assignment Agreement. That statute imposes a six-year period of limitations.

Under New York law, that period runs from the date of the breach:

> Generally, any Statute of Limitations begins to run when a cause of action accrues (C.P.L.R. 203(a)). In New York, a breach of contract cause of action accrues at the time of the breach.

Ely-Cruikshank Co. v. Bank of Montreal, 81 N.Y.2d 399, 402, 599 N.Y.S.2d 501, 502, 615 N.E.2d 985, 986 (1993). *See also John J. Kassner & Co. v. City of New York*, 46 N.Y.2d 544, 550, 415 N.Y.S.2d 785, 788, 389 N.E.2d 99, 102 (1979); *Edlux Constr. Corp. v. State*, 252 A.D. 373, 374, 300 N.Y.S. 509, 511 (1937), *aff'd*, 277 N.Y. 635, 14 N.E.2d 197 (1938).

As Vice Chancellor Strine found, the alleged breach of contract occurred not later than 1986 when AmBase received the IRS Report and assumed the responsibility of defending against the IRS claim. That Report notified AmBase of the nature of the IRS claim and its approximate amount. Under AmBase's theory of this case, the Trust was responsible for the defense of that claim. AmBase could, therefore, have asserted a claim against the Trust upon receipt of the IRS Report. (Strine Op. 4, 8.) As a result, AmBase's cause of action accrued in 1986 and is barred by C.P.L.R. § 213(2).

Because Vice Chancellor Strine found that, on AmBase's theory of this action, the Trust was responsible for responding to the 1986 IRS Report and that AmBase could have brought this action as early as 1986, AmBase is bound by that accrual decision and estopped from relitigating that issue here. Under New York law, a party is precluded where "(1) the issue in question was actually and necessarily decided in a prior proceeding, and (2) the party . . . had a full and fair opportunity to litigate the issue". *Whitney Holdings, Ltd. v. Givotovsky*, 988 F. Supp. 732, 737 (S.D.N.Y. 1997) (Kaplan, J.) (quoting *Colon v. Coughlin*, 58 F.3d 865, 869 (2d Cir. 1995)). Both conditions have been satisfied in this case.

Even if this Court were to find that AmBase is free to relitigate this issue, Vice Chancellor Strine's decision is clearly correct. Since receipt of the IRS Report put AmBase on notice as to the nature of the Income Tax Liability and its amount and triggered a duty to defend, AmBase could have sued the Trust in 1986. Since settled law marks the accrual for an action sounding in contract from the contractual breach, and since nominal damages are always available in contract actions, all the elements necessary to maintain a lawsuit and obtain relief in court were present at the time of the alleged breach in this case. *See, e.g., Kronos, Inc. v. AVX Corp.*, 81 N.Y.2d 90, 94-95, 595 N.Y.S.2d 931, 933-34, 612 N.E.2d 289, 291-92 (1993).

Accordingly, Count I of the Complaint is time barred because 14 years have elapsed since accrual of the cause of action. Count II, labeled Restitution, Unjust Enrichment and Implied Contract, is also barred by C.P.L.R. § 213(2) because it seeks as damages the expenses incurred by AmBase since 1986 in defending the tax claim and is based on the alleged breach of contract. The same is true of Count IV, labeled "Indemnification".

II. COUNT III OF THE COMPLAINT ALLEGING A BREACH OF FIDUCIARY DUTY FAILS TO STATE A CAUSE OF ACTION AND IS BARRED BY THE SIX-YEAR PERIOD OF LIMITATIONS IN C.P.L.R. § 213(7)

AmBase has no standing to assert a breach of fiduciary duty against defendants Scharffenberger, Pyne and Mantell because AmBase was a wholly owned subsidiary of City alit the time the Assignment Agreement was entered into. As officers and directors of City, the individual defendants owed a duty to City and its stockholders. As this Court put the point in *Aviall, Inc. v. Ryder System, Inc.*, 913 F. Supp. 826, 832 (S.D.N.Y. 1996):

> [T]hose who operate the parent company owe no fiduciary duties to the wholly owned subsidiary, and even when the parent company announces a proposed spin-off of the subsidiary, the directors of the parent and the directors of the subsidiary owe no fiduciary duties to the soon-to-be independent subsidiary's prospective stockholders.
>
> Because the officers and directors of a parent company owe allegiance only to that company and not to a wholly owned subsidiary, it is reasonable to conclude that a parent corporation itself is under no obligation to provide the subsidiary with independent representation during the spin-off process. . . . Aviall has not cited, and I have not found any case imposing more exacting duties on a parent, or holding that the form or content of a particular spin-off agreement constitutes a breach of the fiduciary duties owed to the stockholders of either the parent or the subsidiary.

In reaching this conclusion, the Court relied on the well-known Delaware precedent, *Anadarko Petroleum Corp. v. Panhandle Eastern Corp.*, 545 A.2d 1171, 1174 (Del. 1988) in which the Delaware Supreme Court rendered the modern articulation of that principle.

That principle is fully applicable to this case. AmBase was a wholly owned subsidiary of City at the time the Assignment Agreement was entered into in August 1985. The Assignment Agreement was entered into incident to City's liquidation. Under that agreement, AmBase assumed certain tax and other liabilities from City so that City could proceed with its distribution in liquidation. City paid AmBase approximately $180,000,000 for that assumption. As Vice Chancellor Strine put it, City simply divided its assets and liabilities as between certain wholly owned entities in the manner deemed most advantageous for its

stockholders. City then distributed shares of AmBase and units of the Trust to its stockholders who effectively received distributions of both securities in proportion to City's stock. The transaction raised no issues of fairness as between AmBase and the Trust because both entities were owned by the same persons in the same relative amounts. AmBase, therefore, has no standing to assert a claim of breach of fiduciary duty.

In any event, any claim of breach of fiduciary duty is barred by the statute of limitations. Section 213(7) imposes a six-year period of limitations for breaches of duty asserted by a corporation against a past or present officer or director. There is no longer statute of limitations in the C.P.L.R. which could conceivably apply.

The period of limitations runs from the date of breach:

> CPA § 48(8), Section 213(7)'s predecessor, was enacted in large part to shorten the prescriptive period applicable to claims brought by or on behalf of corporations against their directors, officers or shareholders . . . . The legislature effected this goal not only by reducing the number of years within which to bring claims . . . but also by opting to have such claims accrue upon breach, rather than upon plaintiff's discovery of the breach.

Whitney, 988 F. Supp. at 743.[3]

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[3] There is an exception for breaches alleged to constitute actual fraud. That exception is irrelevant both because AmBase has not alleged actual fraud and because AmBase's claim would still be barred because AmBase did not bring its claim within two years of discovery as required by C.P.L.R. 203(g) and found by Vice Chancellor Strine. (Strine Op. 16.) (See pp. 24-26, infra.)

AmBase's fiduciary duty claim is C.P.L.R. § 213(7) because that breach occurred no later than 1986. AmBase alleges that the individual defendants caused AmBase to "assume the costs and expenses of defending against the alleged withholding tax liability". (Complaint ¶ 16.) As Vice Chancellor Strine found, that assumption occurred not later than 1986 when AmBase received the IRS Report. While the individual defendants may have allegedly taken other actions claimed to be breaches of fiduciary duty at a later time, the breach initially occurred no later than 1986. As Vice Chancellor Strine noted, AmBase could have asserted its claim at that time. (Strine Op. 4-5, 8.) Accordingly, AmBase's breach of fiduciary duty claim accrued in 1986 and is barred by the six-year period of limitation set forth in C.P.L.R. § 213(7).

III. AMBASE'S NEGLIGENCE AND MALPRACTICE CLAIMS ALLEGED IN COUNT VI ARE BARRED BY C.P.L.R. § 214(6)

In Count VI of the Complaint, AmBase alleges that Mr. Mantell committed professional malpractice by failing to embrace the improbable theory which AmBase has belatedly concocted in an effort to renege on an obligation it had recognized for over 14 years. Vice Chancellor Strine described AmBase's allegation in the following less-than-charitable terms:

> [AmBase] spins a new yarn about the substantial motivations that Mantell had to cover up the Trust's possib[le] liability for the withholding tax liability. The new theory in large part reduces to the assertion that it made little business sense for City to allocate the withholding tax liability to the Trust rather than to AmBase, and that Mantell faced exposure to the Trust

> for his alleged failure to make sure that the liability was allocated to AmBase in the Assignment Agreement.[15]
>
> Putting aside the many reasons that this theory seems improbable,[16] the theory does not explain the over three and a half year delay that followed Mantell's departure from AmBase. Again, it bears emphasis that the supposed motivations that Mantell harbored to favor the Trust were known by AmBase's other directors and officers since 1985. AmBase's argument thus reduces to its assertion that Mantell had placed some Svengali-like spell on AmBase's board that did not wear off until more than three years after he left. (Strine Op. 19-20.)

Section 214(6) imposes a three-year period of limitations on the malpractice claim against Mr. Mantell alleged in Count VI. The acts alleged to have been committed by Mr. Mantell are the same acts as those alleged to constitute the breach of fiduciary duty. Those acts, therefore, took place not later than 1986. As in the case of breach of fiduciary duty, a cause of action for malpractice accrues upon the date of the alleged practice. *See Glamm v. Allen*, 57 N.Y.2d 87, 93, 453 N.Y.S.2d 674, 677, 439 N.E.2d 390, 393 (1982) ("An action for malpractice accrues at the date of the malpractice complained of.").

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[15] The reader should remember that it is the defendants' position that the Assignment Agreement did in fact make AmBase primarily liable for the withholding tax liability. AmBase's assertion that assignment of the disputed liability to the Trust was at least counter-intuitive from a business perspective has the unintended effect of supporting defendants' argument on the merits. [footnote of Vice Chancellor Strine]

[16] The improbability of the theory is well articulated in the defendants' answer to AmBase's reargument motion. [footnote of Vice Chancellor Strine]

AmBase's malpractice action, therefore, accrued no later than 1986 and is clearly time barred.

IV. AMBASE IS NOT ENTITLED TO CLAIM EQUITABLE TOLLING; EVEN IF IT WERE, AMBASE FAILED TO SUE WITHIN THE TWO-YEAR PERIOD FROM DISCOVERY MANDATED BY C.P.L.R. § 203(g)

Under New York law, a plaintiff seeking to avoid a statute of limitations by claiming equitable estoppel must be able to plead that it used reasonable diligence to acquire knowledge of its claim. *See Whitney*, 988 F. Supp. at 747. AmBase cannot do so because it is estopped by Vice Chancellor Strine's findings. Vice Chancellor Strine found that the AmBase Board knew of defendants' positions with the Trust and knew or had reason to know that the defendants might own Trust units. (Strive Op. 13.) He found that under these circumstances, the AmBase Board was not justified in relying upon defendants' view of AmBase's obligations under the Assignment Agreement. (Strive Op. 13.) Vice Chancellor Strine went on to note that neither the Assignment Agreement nor the Internal Revenue Code were unknown to the AmBase Board and that diligence required the Board to look into the matter of AmBase's liability, independent of reliance on the individual defendants. As Vice Chancellor Strine put it:

> Because the AmBase board chose to rely on Mantell with full knowledge of his Trust affiliations, AmBase contends that it had until the end of the universe to file this suit. I continue to reject this view that corporations and their directors have no obligation to act in a commercially diligent manner in discovering and asserting claims. (Strive Op. 20.)

Moreover, under New York law, there is no equitable tolling absent actual fraud. Allegations of constructive fraud will not suffice. *See Whitney*, 988 F. Supp. at 744, 747; *Quadrozzi Concrete Corp. v. Mastroianni*, 56 A.D.2d 353, 356, 392 N.Y.S.2d 687, 688 (1977). AmBase cannot, and does not, allege actual fraud. Therefore, all of AmBase's cause of action accrued upon breach of the duty and not upon some later discovery of the breach.

Finally and most conclusively, even if AmBase had alleged actual fraud, AmBase should have sued within two years of the time when the plaintiff discovered the relevant facts or "from the time when facts could with reasonable diligence have been discovered", as required by C.P.L.R. § 203(g). *See, e.g., Stride Rite Children's Group, Inc. v. Siegel*, 269 A.D.2d 875, 876, 703 N.Y.S.2d 642, 643 (2000). As this Court ruled in *Union Carbide Corp. v. Montell, N.V.*, 944 F. Supp. 1119, 1138 (S.D.N.Y. 1996): "[The] doctrine of equitable tolling is 'subsumed within [C.P.L.R.] 203(g)' . . . Therefore, 'applicability of [the equitable tolling] doctrine cannot extend the limitations period beyond the two years prescribed by the statute.'" (*quoting Glynwill Investments, N.V. v. Prudential Sec., Inc.*, 1995 WL 362500, *4 (S.D.N.Y. June 16, 1995)). Vice Chancellor Strine said:

> I held that no later than December 1996 AmBase was on full inquiry notice and possessed all the knowledge it needed to bring its claim. (Strine Op. 16.)

As a result, AmBase is collaterally estopped to deny knowledge of its claims at any time after December 1996. Since AmBase failed to sue within two years of that date, its complaint would also be barred by C.P.L.R. § 203(g).

V. AMBASE'S CLAIMS ARE BARRED BY LACHES

Under New York law, "[l]aches is defined as such neglect or omission to assert a right as, taken in conjunction with the lapse of time, more or less great, and other circumstances causing prejudice to an adverse party, operates as a bar in a court of equity.' The essential element of the equitable defense is delay prejudicial to the posing party." *Matter of Barabash*, 31 N.Y.2d 76, 81, 334 N.Y.S.2d 890, 894, 286 N.E.2d 268, 271 (1972) (citations omitted). In this case, Vice Chancellor Strine also held that AmBase's claim was barred by laches. Vice Chancellor Strine found:

(1) "In the alternative, I held that the doctrine of laches also barred AmBase's claim. I based that alternative holding on the facts pled in the complaint, and concluded that those facts demonstrated that the requisite elements of laches existed." (Strine Op. 16.)

(2) "AmBase had reason to know of its claims for quite a long time, but did not assert them until August 2000." (*Id.*)

(3) "During the long delay that had transpired since the withholding tax liability first emerged in 1986, the Trust had taken actions in reliance upon the undisputed fact that AmBase had acted as if it was primarily liable for the disputed tax. In particular, the Trust had distributed out assets that could have been used to satisfy the liability." (*Id.*)

Vice Chancellor Strine also noted that the Trust could have also paid the tax of $21,000,000 and avoided the accrual of interest, which AmBase claims is now approximately $120,000,000. (Strine Op. 17; Complaint ¶ 12.) All of these facts led Vice Chancellor Strine to conclude that AmBase's

claim was also barred by laches. The very same considerations justify the very same result in this case. Indeed, since the issue in this case is identical to that decided by Vice Chancellor Strine and since AmBase had a full and fair opportunity to litigate the issue, AmBase is bound by that decision.

Conclusion

For the reasons stated, Defendant City Investing Company Liquidating Trust respectfully requests that the Court dismiss this action as against all defendants. The Trust also respectfully suggests that sanctions under Fed. R. Civ. P. 11 are appropriate, given the circumstances of this case.

February 23, 2001

Cravath, Swaine & Moore

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IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

AMBASE CORPORATION, a Delaware corporation, Plaintiff, v. CITY INVESTING COMPANY LIQUIDATING TRUST, as Successor to CITY INVESTING COMPANY, a dissolved Delaware corporation, and GEORGE T. SCHARFFENBERGER, EBEN W. PYNE and LESTER J. MANTELL, Individually and as Trustees of the CITY INVESTING COMPANY LIQUIDATING TRUST, Defendants.	No. 01 Civ. 0771 (LLS)

PLAINTIFF'S MEMORANDUM IN OPPOSITION TO DEFENDANT CITY INVESTING COMPANY LIQUIDATING TRUST'S MOTION TO DISMISS

Plaintiff AmBase Corporation ("AmBase" or "Plaintiff"), respectfully submits the following opposition to the Motion to Dismiss filed by Defendant City Investing Company Liquidating Trust ("the Trust" or "Defendant") with this Court February 23, 2001.

PRELIMINARY STATEMENT

According to Defendant, this case is at bottom an action for a breach of contract that occurred in 1986, and that is therefore precluded by the six-year Statute of Limitations found in the CPLR. Specifically, Defendant characterizes

four of AmBase's six counts as being based directly on AmBase's breach of contract claim and as therefore barred by CPLA §213 (2).

* * *

This request had absolutely nothing to do with an analysis of whether or not the Agreement's assignment of responsibility for "income taxes of City ... as common parent of the City Affiliated Group" encompassed *withholding* taxes. Rather, the request dealt solely with how AmBase might be able to deal with the fact that City's business records substantiating its earlier deductions had been lost, raising the possibility that the IRS would, in its audit of City's prior tax years, hold AmBase responsible for paying the increased federal *income* tax liability that was quite obviously attributable to City as common parent of its consolidated group. While the Willkie letter states its understanding of the Agreement in broad language, it quite clearly does not address the question presented by this case or any question even analogous to it. Accordingly, the Defendant has mischaracterized the Willkie letter by asserting that this letter somehow undermines AmBase's allegations regarding the failure by the individual defendants to seek professional advice on whether the Agreement assigned the Withholding Obligation to AmBase, and regarding the fact that the individual defendants caused AmBase to assume the costs of litigating the Issue.

Because the Willkie letter did not address the question, and because no independent tax professional was ever asked to address the question, AmBase did not discover the fact that the Agreement did not cover the Withholding Obligation until the summer of 2000. While the Defendant quotes from the Delaware court's statements regarding the fact that a majority of the AmBase board was independent of the Trust and was fully cognizant of the affiliation with the Trust of the three individual defendants, the fact remains that the only person with the requisite tax skills who would actually have

been likely to have reviewed the Agreement to see if it encompassed withholding tax is defendant Mantell. There would have been no reason for any AmBase board member to have questioned Mantell's determination that the Agreement properly assigned the Withholding Obligation to AmBase. By contrast, there would have been good reason for this issue to occur to an experienced tax professional like Mantell who was in charge of managing all of AmBase's tax issues. Nevertheless, there is no evidence that he ever asked any of his employees or AmBase's outside tax specialists to consider the issue. Indeed, the outside tax specialists engaged by Mantell to litigate the Withholding Obligation with the IRS were not even given the Agreement by Mantell. *See* Ex. D, ¶¶ 9-10.

SUMMARY OF ARGUMENT

The Defendant argues that AmBase's claim is time-barred. Principally, the Defendant argues that AmBase is precluded from bringing the instant action by a recent decision by the Delaware Chancery Court dismissing a similar action brought by AmBase against the same defendants. The actual holding of the Delaware Chancery Court was that AmBase's claims in that action fell outside of the applicable three-year statute of limitations because the claim had accrued and could have been brought no later than December 1996, when Mantell left AmBase. While AmBase strongly believes the Delaware court was in error, it is sufficient for this action simply to point out that, even according to the Defendant, the applicable limitations period for all but one of the counts in this action is six years, not three. *See* MTD at 14-15. Thus, to the extent it is appropriate to test any of AmBase's claims as if they accrued as of December 1996, the Delaware decision in no way precludes AmBase from advancing these claims in New York.

More importantly, Defendant seeks to cast this case as an action based on an alleged breach of contract that took place in 1986. But, contrary to the Defendant's characterization of AmBase's complaint, AmBase has not asserted any claim for breach of contract, nor even alleged that the Agreement has been breached. Indeed, a breach of the Agreement will not -- can not -- occur until such time as the underlying withholding tax liability is judicially determined to exist. The heart of this case is AmBase's request for a judgment declaring that the Trust rather than Abase *will* be primarily liable for the Withholding Obligation *if* any such withholding tax is ultimately held to be due and owing to the United States. Under the law of New York, and everywhere else, a declaratory judgment action that seeks to resolve a dispute over how a *future* or *contingent* liability is to be paid cannot be time-barred when the cause of action to dispute the payment of the underlying liability has itself not yet accrued. This commonsense result demonstrates that AmBase cannot be time-barred from bringing this action to have the Court *declare* that the Trust *will* be primarily liable for the Withholding Obligation in the event that the IRS prevails in the Tax Court litigation, and, accordingly, to enjoin the Trust from making any further distributions of its assets that would increase AmBase's exposure to additional risk of *secondary* liability for the withholding tax (if any is due).

AmBase also alleges that the management of AmBase by defendants, and in particular the management of AmBase's tax matters by defendant Mantell, has caused AmBase to incur substantial expenses in litigating against the IRS, expenses that the Trust should itself have borne because it is in fact primarily liable for the Withholding Obligation. The majority of these expenses have been incurred since receipt of the IRS's Notice of Deficiency in May of 1995. In addition, AmBase alleges that during the course of Defendants' management and control of both AmBase and

the Trust from 1986 through 1996, Defendants breached their duties to AmBase by causing AmBase to believe that it was primarily liable for the Withholding Obligation, and caused the Trust to pay out $280 million dollars in distributions, thereby increasing AmBase's exposure on the Withholding Obligation as the entity that is secondarily liable. Defendants caused AmBase to believe that it was primarily liable for the Withholding Obligation by not informing AmBase that the Agreement did not cover this tax, and by not retaining qualified outside counsel to review the Agreement in order to confirm that the Withholding Obligation was not actually covered by the Agreement. This continuous breach of fiduciary duty, which persisted right up to Mantell's December 1996 departure from AmBase resulted in the defendants' collective unjust enrichment to the extent that AmBase bore the expense of defending against the IRS's challenge. Moreover, because of the defendants' failure to disclose or acknowledge the truth to AmBase regarding the Withholding Issue, they are estopped from arguing that these claims are time-barred. For the same reason, AmBase's claims against defendant Mantell for professional malpractice should be allowed to proceed.

ARGUMENT

I. THE DECISION OF THE DELAWARE COURT OF CHANCERY APPLIED A THREE-YEAR STATUTE OF LIMITATIONS AND THEREFORE DOES NOT PRECLUDE THIS CASE

In its Statement of Facts, the Defendant quotes extensively from the February 7, 2001 opinion by Vice Chancellor Strine reaffirming his dismissal of AmBase's Complaint in the Delaware Chancery Court ("Delaware Opinion"). Defendant appears to rely upon the Delaware Opinion chiefly for the proposition that AmBase could have sued the Trust in 1986 for the same breaches on which it sues

in this action. *See* MTD at 18-19, 22-23, 24. The Defendant places great reliance on this proposition, and even goes so far as to assert that it *precludes* this Court from allowing this action to proceed.

As the Defendant's own memorandum makes quite clear, however, the Delaware Opinion plainly does not foreclose the current action for the simple reason that the Delaware Opinion rested upon a statute of limitations that is three years *shorter* than the statute of limitations applicable in this case. Defendant accurately summarizes the holding of the Delaware Chancery Court on page 14 of its memorandum, stating that "Vice Chancellor Strine concluded that AmBase's claim was barred because AmBase had failed to sue within three years of December 1996." MTD at 14. Immediately after reciting this basic fact, the Defendant moves on to summarize its legal arguments by stating that AmBase's Counts I, II, III, IV, and V are all barred by New York's *six year* statute limitations that applies to each those actions. Thus, Defendant concedes that AmBase has filed its Complaint within six years of the date Vice Chancellor Strine used as the starting point for his statute of limitations analysis, yet nevertheless argues, incongruously, that New York's six-year statute of limitations bars this action. Far from precluding the instant case, the Delaware Opinion simply casts into sharp relief why AmBase's claims, while possibly time-barred in Delaware, are certainly viable in New York.

Moreover, while the Defendant cites to various portions of the Delaware Opinion that describe why AmBase may have been injured as early as 1986, it is quite clear that these descriptions of the case do *not* constitute elements of Vice Chancellor Strine's holding. Rather, the foundations for the holding are that (1) AmBase's claims were "ripe as of 1995, if not in 1986," (Delaware Opinion at 9), (2) applying Delaware law, Vice Chancellor Strine held that it was

appropriate to apply a three-year statute of limitations to all of AmBase's claims, including its claims for a declaratory judgment and injunctive relief (Delaware Opinion at 10), and (3) the statute of limitations was not equitably tolled beyond December of 1996 since as of that month the individual defendants were no longer officers or directors of AmBase (Delaware Opinion at 10-16).

While AmBase certainly takes issue with the Delaware Opinion, it is wholly untenable to argue that the decision in any way precludes AmBase's New York action. As Defendant recites, New York precludes a party from rearguing an issue only where "the issue in question was actually and necessarily decided in a prior proceeding, and (2) the party ... had a full and fair opportunity to litigate the issue." *See Whitney Holdings Ltd. v. Givotovsky*, 988 F. Supp. 732, 737 (SDNY 1997) (Kaplan, J.) (*quoting Colon v. Coughlin*, 58 F.3d 865, 869 (2d Cir. 1995)). None of the three necessary elements to the holding of the Delaware Chancery Court are being placed at issue in this case. AmBase's claims in New York do not depend upon whether AmBase's claims were ripe in 1995, nor upon whether Delaware law imposes a three-year statute of limitations on all of AmBase's claims including those for a declaratory judgment and an injunction, nor upon whether it is possible to equitably toll the statute of limitations beyond December of 1996. Stated differently, even if all three of the "necessarily decided" elements of the Delaware Opinion are binding in this action, AmBase still has a viable cause of action for each of its claims. The simple reason for this is that, as the Defendant acknowledges throughout its brief, New York applies a six-year limitations period to AmBase's actions, which therefore allows AmBase to bring those actions *even if* AmBase's causes of action are held to have accrued as of December 1996, and *even if* Delaware law would apply a three-year statute of limitations and would time-bar even the declaratory judgment relief AmBase seeks.

These "foundational elements" to Delaware Opinion, while possibly incorrect and while certainly adverse to AmBase in Delaware, do not stand in the way of AmBase bringing its cause before this Court.

* * *

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

AmBASE CORPORATION, a Delaware corporation,

Plaintiff,

-against-

CITY INVESTING COMPANY LIQUIDATING TRUST, as Successor to CITY INVESTING COMPANY, a dissolved Delaware corporation, and GEORGE T. SCHARFFENBERGER, EBEN W. PYNE and LESTER J. MANTELL, Individually and as Trustees of the CITY INVESTING COMPANY LIQUIDATING TRUST,

Defendants.

01 Civ. 0771 (LLS)

MEMORANDUM OF LAW

* * *

Further, contrary to the assertion of the defendants, the Delaware Court's decision does not enjoy preclusive effect. Delaware does not give preclusive effect to dismissal on statute of limitation grounds. Certainly, the Vice Chancellor's holding (as opposed to dicta) does not in any event preclude this action. Accordingly, accepting the applicable six-year statute of limitations and the earliest

possible accrual date of May 1995, no legal grounds exists for the dismissal of the Complaint.[5]

Given the absence of a legal or factual basis for the motion to dismiss, coupled with the legitimate basis for amending the Complaint, AmBase requests that the Court deny defendants' motions in their entirety and grant AmBase leave to serve and file an Amended Complaint.

II

THE DECISION OF THE DELAWARE CHANCERY COURT HAS NO PRECLUSIVE EFFECT

Examined under the applicable law, the prior decisions of the Delaware Court have no preclusive effect on the case before this Court. The Supreme Court has "now settled that a federal court must give to a state-court judgment the same preclusive effect as would be given that judgment under the law of the State in which the judgment was rendered." *Migra v. Warren City School Dist. Bd. of Education*, 465 U.S. 75, 81 (1984). *See also Allen v. McCurry*, 449 U.S. 90, 96

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[5] AmBase requests that in the event the Court were to grant or deny the motions to dismiss, it be given leave to file its Amended Complaint. Along with deleting the current claim against defendant Mantell solely, the proposed Amended Complaint would establish a series of contract and contract-related claims against the Trust. These previously unpled claims relate back directly to the original set of allegations, and clarify AmBase's role and the specific injuries that it has suffered. The Second Circuit has upheld a party's right to enjoy the opportunity to amend its Complaint, even when the court dismisses the original Complaint. *See Ronzani v. Sanofi S.A.*, 899 F.2d 195, 198 (2d Cir. 1990). Here, leave to amend has become necessary as post filing events have occurred: the Tax Court has finally resolved the Withholding Tax Litigation and, consistent with its contractual arrangements with the Trust, AmBase may now recover the costs and other damages that it incurred in its role as agent for City Investing in that matter.

(1980). The Second Circuit adheres to this twenty-year-old rule. *See H. Frederick Johnston v. Arbitrium (Cayman Is.) Handels AG*, 198 F.3d 342, 347 (2d Cir. 1999) analyzing prior holding of Delaware Chancery Court under Delaware law). *See also Conopco, Inc. v. Roll Internat'l*, 231 F.3d 82, 87 (2d Cir. 2000) (citing *Migra* and continuing that "[f]ederal courts may not 'employ their own rules . . . in determining the effect of state judgments,' but must 'accept the rules chosen by the State from which the judgment is taken'") (authority omitted)). Indeed, your Honor has recognized and applied this doctrine previously in *Clissuras v. Equal Employment Opportunity Commission*, 1990 U.S. Dist. LEXIS 8284 (S.D.N.Y. 1990) (Stanton, J.). Accordingly, Delaware Law will dictate the degree to which this Court shall give the Delaware Court's decisions any preclusive effect.

Delaware courts do not give collateral estoppel effect to prior judicial determinations with respect to the statute of limitations. Delaware courts have noted "that a judgment based on the forum's statute of limitations is not a ruling on the merits and is not, therefore, entitled" to any preclusive effect in a later action in another jurisdiction. *Cappello v. Patrician Towers, Inc.*, 1981 Del. LEXIS 272 (Sup. Ct. of Delaware 1981); *Equity Corporation v. Groves*, 30 Del. Ch. 68, 73, 53 A.2d 505, 507-8 (1947). The statute of limitations merely affects the complainant's remedy in the State in which the suit is brought, and not the right of the matter involved in the action. *See Equity Corporation v. Groves*, 30 Del. Ch. at 73. In fact, the United States Supreme Court recently acknowledged in *Semtek Internat'l Inc. v. Lockheed Martin Corp.*, 531 U.S. 497 (2001), that the expiration of the applicable statute of limitations merely bars the remedy and does not extinguish the substantive right, so that a dismissal on such grounds does not have preclusive effect in other jurisdictions with longer unexpired limitation periods.

Similarly, dismissals in Delaware based upon laches are not on the merits. The Court of Chancery in Delaware will give considerable weight to the statute of limitations -- notwithstanding that the statute applies to law actions only -- when passing on the defense of laches. *Fontana v. Julian*, 1979 Del. Ch. LEXIS 388. Where the statute of limitations bars the legal remedy, it shall bar the equitable remedy, unless unusual or extraordinary circumstances render its application inequitable. *Id.* Given the fact that dismissals on the statute of limitations are not on the merits in Delaware, *Cappello v. Patrician Towers*, 1981 Del. LEXIS 272, it follows that dismissals based upon laches where the applicable statute of limitations was considered, are also not on the merits. *See Fontana v. Julian*, 1979 Del. Ch. LEXIS 388.

Although caselaw is sparse, the holdings in *James Julian Inc. v. Dept. of Transportation of the State Delaware*, 1991 Del. Ch. LEXIS 162 and *Ritter v. Ritter*, 1979 Del. Ch. LEXIS 370, suggest that dismissal upon the grounds of laches are not on the merits and have no preclusive effect. In *James Julian*, the Chancery Court stated that it would normally address a defense of laches before considering the merits of the claims, because if the laches defense were valid, the Court would not reach the merits. *James Julian Inc. v. DOT*, 1991 Del. Ch. LEXIS 162. In *Ritter*, the Chancery Court stated that because of its adverse holding on the merits -- an issue involving duress -- it was not necessary to decide whether the action was barred by laches. Clearly, laches is a procedural issue which is given no preclusive effect. *Ritter v. Ritter*, 1979 Del. Ch. LEXIS 370.

The Delaware Court acknowledged that its decision did not constitute a determination on the merits when it founded its decision on the statute of limitations. The Vice-Chancellor specifically stated that he was "putting aside the merits" and dismissing the action solely upon the grounds

that the claims for relief were outside of Delaware's three-year statute of limitations. The judgment on Delaware's statute of limitations was not a ruling on the merits which would have any preclusive effect in a later action in another jurisdiction. *See Cappello v. Patrician Towers*, 1981, Del. LEXIS 272. Accordingly, it necessarily follows that the Delaware judgment does not preclude this subsequent action in this Court in New York where the statute of limitations is six (6) years.

Defendants undermine the legitimacy of their own arguments on this issue when they fail to apply the appropriate legal analysis. (*See* Def. Reply Mem. at 6-8). Ignoring the established legal analysis from the Supreme Court, Second Circuit and this very Court, defendants rely on New York law in order to argue that the Delaware Court's decision should enjoy preclusive effect. I refusing to examine the preclusive effect the decision would enjoy in Delaware, *see Migra v. Warren City School Dist. Bd. of Education*, 465 U.S. at 81 (1984), defendants apply the wrong law and the incorrect legal analysis. Their conclusion is simply in error! As already noted, the appropriate legal review confirms that this Court should not give any preclusive effect to the findings of the Delaware Court.

Defendants' argument further lacks recognition of reality when they suggest that this Court confuse dicta with the Delaware Court's actual holding. Only a previous judgment which the court has "clearly and explicitly set forth . . ." will enjoy preclusive effect and ". . . dicta and implications will not suffice." *Salt Pond Investment Co. v. Wilgus*, 1987 Del. Ch. LEXIS 513 (Del. Chan. Ct. 1987) (citing *Equity Corp. v. Groves*, 53 A.2d 505 (Del. Chan. Ct. 1955)).

Defendants uniquely allege that "[a]ny fair reading" of the Delaware Court's decisions support their opinion that the date of accrual occurred in 1986. (Def. Reply Mem. at 6).

(*See also* Def. Reply Mem. at 5, 7, 8) (proclaiming that the Delaware Court held that the accrual date of the breach of contract was 1986). This argument defies both logic and the express language, *in hac verba*, of the Vice Chancellor. Given defendants' apparent concession that the Delaware Court held that the date of accrual occurred in 1995, (Def. Reply Mem. at 6), the suggestion that, as a matter of preclusive fact, a date of accrual nine years earlier exists makes little sense. More importantly, defendants' attempt to rewrite the court's holding and manufacture a different date of accrual is simply disingenuous. The Delaware Court expressly stated that "[g]iving AmBase all of its due, the claim began to run at least as early as the notice of deficiency by challenging it, it is going to be reduced to a judgment." (Dodyk Aff., Exh. A at 4). (*See also* Exh. A at 6) (noting that the statute of limitations period "clearly . . . began running by 95")). The Delaware Court then qualified that date closer to the present date, when it held that AmBase should have discovered any claim based in contract by December 1996. (*Id.* at Exh. A at 5-6). In its decision on reargument, the Delaware Court reaffirmed its holding that the accrual date occurred in 1996. (*Id.*, Exh. C at 8) (stating that the statute of limitations barred any claim three years after the department of Mr. Mantell in 1996); (*id.*, Exh. C at 17) (expressly stating that "I held that it was clear that AmBase's claims were ripe as of December 1996"). (*See also Id.*, Exh. C at 5-6, 9, 14, 15). In light of the court's statement that it held the date of accrual was set in December 1996, this Court should ignore defendants' efforts to contort the dicta of that decision into a fashionable second holding.

* * *

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

AMBASE CORPORATION, a Delaware corporation, Plaintiff, -against- CITY INVESTING COMPANY LIQUIDATING TRUST, as Successor to CITY INVESTING COMPANY, a dissolved Delaware corporation, and GEORGE T. SCHARFFENBERGER, EBEN W. PYNE and LESTER J. MANTELL, Individually and as Trustees of the CITY INVESTING COMPANY LIQUIDATING TRUST, Defendants.	01 Civ. 0771 (LLS)

REPLY MEMORANDUM IN SUPPORT OF DEFENDANT'S MOTION TO DISMISS PURSUANT TO FED. R. CIV. P. 12(b)(6)

Introduction

In its most recent brief (its fourth on the subject),[1] AmBase Corporation ("AmBase") misrepresents the City

[1] AmBase's first brief on this subject was filed on November 15, 2000 in opposition to the Trust's motion to dismiss the Delaware action. AmBase again raised the same issues in its motion for reargument in Delaware, filed January 10, 2001. AmBase next raised these issues on March 9, 2001, in its brief in response to the Trust's motion to dismiss this case. AmBase's latest brief was filed on November 26, 2001.

Investing Company Liquidating Trust's (the "Trust") position, the law of Delaware, Vice-Chancellor Strine's opinion, the law of New York, an Administration Agreement which does not even mention AmBase's assumption of the Income Tax Liability, and the Trust's SEC filings. Specifically, AmBase:

(1) confuses the separate doctrines of *res judicata*, which the Trust did not raise, and collateral estoppel, which is applicable to findings of Vice-Chancellor Strine that are dispositive of this case;

(2) confuses the date on which Vice-Chancellor Strine found AmBase's claims accrued (1986) with the inquiry notice date by which any equitable tolling claim by AmBase expired (December 1996);

(3) pretends that section 203(g) of the C.P.L.R. is inapplicable to limit the period within which a party claiming equitable tolling must file its claims;

(4) pretends that an Administration Agreement which says nothing about AmBase's assumption of the Income Tax Liability here at issue is applicable despite the fact that the agreement was originally entered into between AmBase and the now defunct law firm of Finley Kumble, not the Trust, and was terminated long before resolution of the Income Tax Liability;

(5) pretends that the Assignment and Assumption Agreement (the "Assignment Agreement"), pursuant to which AmBase has defended against the Income Tax Liability, is an indemnity agreement;

(6) pretends that the Trust's SEC filings, which state that "<u>other</u> parties are primarily and jointly liable" for the Income Tax Liability do not mean parties "other" than the Trust despite the plain meaning of the word "other".

ARGUMENT

I. THE FACTUAL AND LEGAL FINDINGS OF THE DELAWARE COURT ARE ENTITLED TO PRECLUSIVE EFFECT IN THIS COURT.

The main point of AmBase's latest brief is that Vice-Chancellor Strine's findings are not entitled to preclusive effect under Delaware (and, therefore, New York) law because the Delaware case was dismissed on statute of limitations grounds and not "on the merits". AmBase's argument misstates the Trust's legal position, conflates the two separate and distinct doctrines of *res judicata* (or claim preclusion), and collateral estoppel (or issue preclusion), and misrepresents Delaware law.

The Trust has never raised *res judicata*, or claim preclusion, as a basis for dismissal of this case. Instead, the Trust has consistently maintained that the findings which the Vice Chancellor made in his ruling should be given *issue preclusive* effect.

"Collateral estoppel and *res judicata* are related but distinct doctrines that may bar a party from litigating certain issues or claims in a subsequent proceeding." *Epperson v. Entm't Express, Inc.*, 242 F.3d 100, 108 (2d Cir. 2001). Under the doctrine of *res judicata*, or claim preclusion, "a final judgment on the merits of an action precludes the parties or their privies from relitigating issues that were or could have been raised in that action." *Leather v. Ten Eyck*, 180 F.3d 420, 424 (2d Cir. 1999). In contrast, collateral estoppel "precludes a party from relitigating in a subsequent action or proceeding an issue clearly raised and decided against that party . . . whether or not the tribunals or causes of action are the same." *Id.* at 425.

Claim preclusion is ordinarily created by a judgment on the merits. However, it is black-letter law that a question of fact actually litigated and resolved in a prior proceeding is entitled to *collateral estoppel* effect--even if the prior case is dismissed on statute of limitations grounds. The Delaware Supreme Court has explicitly recognized the difference between *res judicata* and collateral estoppel, and has given preclusive effect to findings of fact even though the previous court did not adjudicate plaintiff's claims on the merits. *See Stephenson v. Capano Dev., Inc.*, 462 A.2d 1069, 1073 (Del. 1983); *Winkler v. Balentine*, 254 A.2d 849, 851 (Del. 1969).

AmBase mistakenly claims that the Delaware cases it cites, *Cappello v. Patrician Towers, Inc.*, No. 102, 1981 Del. LEXIS 272 (Del. Jan. 14, 1981) and *Equity Corporation v. Groves*, 53 A.2d 505 (Del. Ch. 1947), stand for the proposition that Delaware courts do not issue preclusive effect to judicial findings of previously litigated facts if the prior case was dismissed on statute of limitations grounds. (AmBase Br. at 17). In fact, the *Cappello* case dealt only with claim preclusion, and not with collateral estoppel. The court in *Cappello* held "that a judgment based on the forum's statute of limitations is not a ruling on the merits and is not, therefore, entitled to *res judicata* effect in a later action in another jurisdiction." *Cappello*, 1981 Del. LEXIS 1980, at *2-3 (emphasis added). By cutting off its quote of the court's opinion to eliminate the words "*res judicata*" and inserting its own phrase: "any preclusive effect", AmBase misrepresents the holding of the case.

In *Cappello*, the plaintiff had previously brought identical claims in Virginia, which were dismissed because they were not brought within Virginia's three-year statute of limitations. The *Cappello* court unsurprisingly held that the prior ruling that the claims were time-barred under Virginia law did not have the *res judicata* effect of determining that those claims were time-barred under Delaware law. The

court made clear, however, that its ruling was only that the Delaware trial court should not have accorded *res judicata* effect "to *that aspect* of the Virginia judgment." *Cappello*, 1981 Del. LEXIS, at *3.

Neither *Cappello* nor *Equity Corp.* in any way suggested that previously-litigated questions of fact or law actually adjudicated by the prior tribunal were not entitled to collateral estoppel effect.

The Trust has never argued that *res judicata* bars AmBase from bringing a claim in New York because that claim was previously dismissed in Delaware on statute of limitations grounds. The Trust's position is only that the Delaware court's factual findings are entitled to issue preclusive effect in this Court. Applying New York law to those previously adjudicated facts requires the dismissal of AmBase's claims because they are time-barred under *New York law*.

Vice Chancellor Strine made at least four findings that are entitled to preclusive effect: (1) AmBase's claims against the Trust accrued in 1986 (Strine Op. 8-9; Strine Oral Op. 4); (2) AmBase was on full inquiry notice of the existence of these claims no later than December 1996 (Strine Op. 14-16; Strine Oral Op. 5); (3) AmBase's alleged reliance on the Trustee defendants in connection with the Income Tax Liability was unreasonable as a matter of law, and could not support equitable tolling of the statute of limitations (Strine Op. 10-14; Strine Oral Op. 4-5); and (4) AmBase's claims are barred by the doctrine of laches (Strine Op. 16-17; Strine Oral Op. 6-7).

New York law clearly grants preclusive effect to factual determinations even when "the issue precluded was the subject of only an alternative determination by the trial court." *Malloy v. Trombley*, 50 N.Y.2d 46, 52, 405 N.E.2d

213, 216 (1980). Seeking to avoid the thrust of theses cases, AmBase makes the untenable claim that *Malloy* does not apply "where the preclusive effect of the prior proceeding is determined pursuant to Delaware law." (AmBase Br. at 23) AmBase's baseless claim that the "alternative determination" doctrine is applicable only where the previous adjudication applied New York law finds no support in principle or precedent. AmBase aiso derides the Trust's "unique and creative application of New York's 'alternative determination' theory to the collateral estoppel doctrine." (AmBase Br. at 22). In fact, the New York doctrine of "alternative determinations" is clearly applicable to collateral estoppel cases. *See Malloy v. Trombley*, 50 N.Y.2d 46, 52, 405 N.E.2d 213, 216 (1980); *Aldrich v. State*, 110 A.D.2d 331, 332, 494 N.Y.S.2d 662, 663 (1985).

Finally, AmBase's counsel have not argued that standards under New York law differ from standards under Delaware law in any way which would undermine Vice-Chancellor Strine's findings, nor could they. Vice-Chancellor Strine's findings that AmBase's claims accrued as early as 1986, that AmBase was on full inquiry notice of its claims not later than December 1996, that AmBase's alleged reliance on the trustees was unreasonable, and that AmBase's claims are barred by laches could have as easily been found by a Justice of the New York State Supreme Court, or this Court.

II. VICE CHANCELLOR STRINE'S CLEAR AND DISTINCT FINDINGS ON BOTH THE ACCRUAL DATE OF THE CAUSE OF ACTION, AND THE DATE BY WHICH AMBASE WAS ON FULL INQUIRY NOTICE, BAR AMBASE'S CLAIMS.

In addition to confusing the law of claim and issue preclusion, AmBase tries to muddy the distinction between Vice-Chancellor Strine's finding as to the accrual date of

AmBase's cause of action, and his finding as to when AmBase had inquiry notice of the alleged breach. Both of these separate findings should be given preclusive effect, and bar AmBase's claims under New York's statute of limitations.

Vice-Chancellor Strine made a clear finding, in both his oral and written opinions, that AmBase's claims against the Trust accrued in 1986, when the IRS issued its Revenue Agent's Report asserting its claims with respect to the Income Tax Liability and when "AmBase had a litigable dispute with the Trust over which entity should have to deal with the IRS" (Strine Op. 8-9):

> I believe in this circumstance if AmBase believed that it was being subjected to liability . . . it could have immediately sued . . . . I think that kind of suit could have been brought in 1986. (Strine Oral Op. 3).
>
> AmBase could have brought this action against the Trust as early as 1986, when the Revenue Report was issued . . . . [A]s AmBase's claims for reimbursement for its expenses back to 1986 demonstrates, AmBase had a litigable dispute with the Trust over which entity should have to deal with the IRS. (Strine Op. 8-9)

Contrary to AmBase's repeated assertions, the Vice Chancellor never held that AmBase's cause of action against the Trust accrued only in 1995 or December 1996. (See AmBase Br. at 10, 11, 14, 21, 23, 24.)

* * *

02-7230

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT
DOCKET NO. 00-7230

AMBASE CORPORATION, A Delaware Corporation,

Plaintiff-Appellant,

V.

JOHN J. QUIRK, Trustee of City Investing Company Liquidating Trust, and MARION SCHARFFENBERGER, Executrix of the Estate of George T. Scharffenberger, EBEN W. PYNE, Individually and as Trustee of the City Investing Company Liquidating Trust, LESTER J. MANTELL, Individually and as Trustee of the City Investing Company Liquidating Trust,

Defendant-Appellee.

ON APPEAL FROM UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF OF PLAINTIFF-APPELLANT AMBASE CORPORATION

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* * *

Utilizing New York's six-year statute of limitations period, N.Y. C.P.L.R. § 213, AmBase sought relief under four legal theories: (i) an unjust enrichment restitution or implied contract claim against the Trust and the Trustees; (2) an indemnification claim against the trust and the Trustees; (3) a breach of fiduciary duty claim against Scharffenberger, Pyne and Mantell individually; and (4) a fraudulent conveyance claim against the Trust.[13]

AmBase sought reimbursement from the Trust for any expenses and damages incurred in defending against the potential withholding tax obligation, because the Trust had the responsibility for defending against that claim. JA7-8. Also, because the Tax Court had not yet ruled when AmBase filed suit in New York, AmBase sought a declaratory judgment that the Trust, not AmBase, was primarily liable for any tax eventually owed. *Id.*

On May 23, 2001, the Tax Court rejected the IRS's position and ruled that no withholding tax liability was due. The IRS did not appeal this decision. By this time, however, AmBase had incurred legal expenses and related costs in the amount of approximately $3.2 million in connection with the IRS dispute and had suffered damages from carrying this potential tax liability on its balance sheet.

Following the Tax Court ruling, AmBase sought to add two additional claims against the Trust and the Trustees – a breach of contract claim and a third-party beneficiary

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[13] Under a fifth theory, AmBase pursued a professional negligence and malpractice claim against Mantell. AmBase has since dropped this claim.

claim.[14] During an October 26, 2001 conference in the case, and before the court had even acted on defendants' motion to dismiss, AmBase requested leave to file an amendment to its Complaint. JA949. AmBase had not previously sought leave to amend its Complaint. The District Court stated that it would consider AmBase's request after it had addressed the defendant's motion to dismiss the original Complaint.

The District Court Dismisses AmBase's Complaint. At the outset of this action, the defendants moved under FED. R. Civ. P. 12(b)(6) to dismiss AmBase's Complaint on statute of limitations grounds, arguing, in large measure, that the District Court should give preclusive effect to the decision of the Delaware Court regarding the Delaware statute of limitations. The motion to dismiss was never converted to a summary judgment motion. On January 11, 2002, the District Court dismissed AmBase's complaint without providing AmBase the opportunity to replead it had requested on several occasions. SA1.

As an initial matter, Judge Stanton rejected defendants' claim that the Delaware Court's decision under Delaware law had any preclusive effect in this proceeding, noting that New York's longer limitations period, which governed in this proceeding, required the court to determine the date of accrual of AmBase's claims under New York law. SA6-7. As the U.S. Supreme Court recently reiterated: "[T]he traditional rule is that expiration of the applicable statute of limitations merely bars the remedy and does not extinguish the substantive right, so that dismissal on that ground does not have claim-preclusive effect in other jurisdictions with

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[14] Pursuant to Judge Stanton's standing rules, AmBase was required first to seek the court's permission to file a motion to amend. Ultimately, the court denied AmBase permission even to file its motion to amend. SA18.

longer, unexpired limitations periods." *Semtek Int'l Inc. v. Lockheed Martin Corp.*, 531 U. S. 497, 504 (2001) (citations omitted).

However, the court then held that all of AmBase's claims against the defendants accrued in March 1986 when the IRS agent issued his report following completion of his audit relating to City Finance. According to Judge Stanton, the agent's report asserted that "AmBase, as agent for City Investing, owed" withholding taxes. In fact, however, at the time the court ruled, a copy of the revenue agent's report was not even before the court since it was not appended to the complaint and could not, therefore, be considered on a motion to dismiss. In any event, the court's characterization of that report is simply not true. Nonetheless, the court held that the six-year limitations period on AmBase's unjust enrichment, restitution and implied contract claim as well as its breach of fiduciary duty claims against the individual defendants all began to run as of the 1986 date, and thus expired long before AmBase brought this action. SA8. As to AmBase's indemnification claim, the court concluded that as a matter of law AmBase had "no basis for a contractual claim of indemnity." SA12.

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According to the Court, these claims, like all the others were time-barred because the six-year statute of limitations for those claims began to run in March 1986 upon issuance of the Agent's Report, and therefore expired in 1992, years before the IRS had even issued its statutory Notice of Deficiency. The District Court abused its discretion in refusing these amendments because under New York's continuing breach doctrine, AmBase is entitled to seek recovery under these contractual claims for any breaches that occurred and any damages it sustained within six years of the filing of the Complaint. It is certainly inappropriate at this early stage of the proceedings to decide as a matter of law

that AmBase will be unable under any set of facts to establish continuing duties on the part of the Trust and its Trustees as well as continuing breaches by those defendants.

Once again, the District Court applied the wrong accrual date - 1986 - and ignored governing New York case law. Applying the six-year statute of limitations period for contract claims, see N.Y. C.P.L.R. § 213(2), the District Court concluded that AmBase's proposed contract-based claims accrued as of March 1986 and expired as of 1992. In reaching that conclusion, the District Court relied primarily on the New York State Court of Appeals' decision in *Ely-Cruikshank Co. v. Bank of Montreal*, 599 N.Y.S.2d 501 (1993), which recites the general rule that the statute of limitations on a contract claim begins to run at the time of breach or when one party omits the performance of a contractual obligation.

However, that general rule is subject to an important exception that the court in *Ely-Cruikshank* itself recognized but the District Court ignored. *See ElyCruikshank*, 599 N.Y.S.2d at 503 (noting that contracts involving obligations that extend over a period of years "warrant different considerations and results under the Statute of Limitations' microscope.") (citation and internal quotation marks omitted). *"'Where a contract provides for continuing performance over a period of time, each breach may begin the running of the statute anew such that accrual occurs continuously and plaintiffs may assert claims for damages occurring up to [the length of the limitations period] prior to the filing of the suit.'"* *Lennon v. Seaman*, 63 F. Supp 2d. 428, 446 (S.D.N.Y. 1999) (quoting *Airco Alloys Div., Airco, Inc. v. Niagara Mohawk Power Corp.*, 430 N.Y.S.2d 179, 186 (4th Dep't 1980) (citations omitted, emphasis added); *see Bulova Watch Co v. Celotex Corp.*, 415 N.Y.S.2d 817, 820 (1979); *see also Cent. Gen. Hosp. v. Bramex Ltd.*, 570 N.Y.S.2d 670, 670-71 (2nd Dep't 1991); *Franza's Universal*

Scrap Metal, Inc. v. Town of Islip, 453 N.Y.S.2d 24 (2nd Dep't 1982).

The concept of a duty (or its breach) arising every time a particular transaction or act occurs is a common principle of statute of limitations law. Indeed, it is evident in the unjust enrichment case law just discussed. The underlying rationale for this rule of contract law - known as the continuing breach rule — is that courts should neither too quickly nor too narrowly define the concept of breach. As New York's highest court has noted in another context:

> If a creditor's action against a guarantor accrues wholly and immediately at the point of the first default in payment - the six-year limitations period for any action against the guarantor clocking in at that point - then creditors would be left with no alternative or incentive but to accelerate the entire debt or risk losing all opportunity to pursue the guaranty. The prudent commercial practice rule would keep in place incentives to the creditor to proceed with some flexibility in working with the debtor based on stipulated contractual provisions. In that dynamic, for example, parties might be able to continue to work toward amicable and fair resolutions between themselves rather than immediately drawing litigation swords and marching off to a courthouse.

Phoenix Acquisition Corp. v. Campcore, Inc., 596 N.Y.S.2d 752, 755 (1993).

Therefore, if, as alleged in this case, "a contract provides for continuing performance over a period of time, each breach may begin the running of the statute anew such that accrual occurs continuously and plaintiffs may assert claims for damages occurring up to six years prior to the filing of the suit." *Airco Alloys*, 430 N.Y.S.2d at 186' *cf. Sporn v. MCA*

Records, Inc., 462 N.Y.S.2d 413, 415 (1983) ("If defendant hits plaintiff's horse repeatedly, plaintiff has a new cause of action upon each striking...") (internal quotation marks omitted). By ignoring the rules that govern claims of a continuing breach in New York, the District Court applied the wrong legal standard in evaluating AmBase's proposed claims.

Whether a party has a continuing obligation under a contract depends upon the nature of the party's obligation and whether it extends over a period of time. The Court of Appeals' decision in Bulova Watch is instructive. There, Judge Fuchsberg, writing for the court, held that a company's promise to keep a roof in good repair for a twenty-year period constituted a continuing obligation. Therefore, each time the roof leaked and the roofing company failed to repair it, the roofing company committed a separate breach and the six-year limitations period ran from the date of each one of those breaches. See Bulova Watch, 415 N.Y.S.2d at 820 (the six-year limitations period ran "separately for the damages occasioned each time a breach of the obligation to repair the bonded roof occurred"); see also, Bramex, 570 N.Y.S.2d at 671 ("... the applicable limitations period is to be measured from the last date upon which the continuing duty was breached"); Franza's Universal Scrap Metal, 453 N.Y.S.2d at 25 ("[T]he wrong complained of here is a continuing one and gives rise to the accrual of successive causes of action for each day's breach of the town's duties under the contract").

Under the Trust Agreement and the Assignment Agreement - each of which continue in effect to this very day since the Trust remains in existence - the Trust and its Trustees had a continuing obligation to pay for the ongoing costs of defending against the withholding tax claim and, if necessary, to pay any tax due. AmBase's proposed contract claims are based on the failure of the Trust and the Trustees

to fulfill their continuing obligations under those agreements to take responsibility for the alleged withholding tax liability and to pay for the continuing costs of defending against the IRS's Notice of Deficiency. As such, the defendants did not commit a single, isolated breach in 1986 when they did not pay the first expense incurred after issuance of the Agent's Report to City. Instead, they committed a continuing series of breaches that extended through 2001. AmBase, therefore, should have been allowed to seek to recover "claims for damages occurring up to six years prior to the filing of the suit." *Airco Alloys*, 430 N.Y.S.2d at 186; *see Bulova Watch*, 415 N.Y.S.2d at 820.[22]

Finally, and in any event, to the extent that there were any question whether the defendants' duties under the Trust and Assignment Agreements were continuing or not, that issue should not have been decided as a matter of law at this preliminary stage of the litigation, as numerous cases in state and federal court have made clear. Thus, in *Airco Alloys*, the appellate court rejected an invitation to determine the applicability of the continuing breach doctrine at the summary judgment stage, much less resolve it at the motion to dismiss stage. *See* 430 N.Y.S.2d at 186. The court rightly held that "[i]n as much as an issue of fact exists with respect to [defendant's] obligations under [the contract], it is not yet possible to determine the issue of accrual of alleged breaches of the contract and, where a triable issue of fact exists with respect to accrual of a claim, such issue should not be determined on motion." *Id.; accord Lennon*, 63 F. Supp 2d. at 446.

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[22] *See* FED. R. CIV. P. 15(c) ("An amendment of a pleading relates back to the date original pleading when . . . (2) the claim or defense asserted in the amended pleading arose out of the conduct, transaction, or occurrence set forth or attempted set forth in the original pleading . . . .").

The obligations of the Trust and the Trustees under the Assignment Agreement and the Trust Agreement did not end in 1986; nor did their breaches end in 1986. So long as the Trust continued in existence, it had a continuing obligation under those agreements to perform its duties - that is, assume responsibility for the alleged withholding liability and to pay for the ongoing costs of defending against the IRS Notice of Deficiency, costs that continued to be incurred into 2001. Thus, the District Court's decision denying AmBase leave to amend its Complaint and dismissing its proposed contract claims as futile should be reversed, and AmBase should be permitted to amend its Complaint to assert these proposed claims.

III. AmBase's Claims Against Scharffenberger and Pyne Are Timely

Like Mantell, Scharffenberger and Pyne, were sued in their individual capacities, as well as in their capacities as Trustees. Scharffenberger served as Chairman of AmBase's Board of Directors for several years as well as its CEO. Pyne served as Vice-Chairman of AmBase's Board of Directors. Both owed a fiduciary duty to AmBase, but, nevertheless, foisted responsibility for the withholding tax liability onto AmBase instead of the Trust in furtherance of their economic interests.

The District Court dismissed AmBase's claims against Scharffenberger and Pyne in their individual capacities as untimely, holding that the six-year statute of limitations period for AmBase's breach of fiduciary duty claims against these individuals expired in 1992, even before their fiduciary relationships with AmBase ended. Once again, the District Court applied the wrong legal standard and in any event acted prematurely.

First, under the doctrine of continuous representation discussed above, *see supra* at 31-35, the six-year limitations period for the breach of fiduciary duty claims against Scharffenberger, Pyne and Mantell did not begin to run until their collective fiduciary relationships with AmBase ended. *See Golden Pacific*, 273 F.3d at 519. While Scharffenberger and Pyne each left AmBase in 1993, Mantell did not leave until December 1996. The complaint alleges that at all relevant times Scharffenberger and Pyne were acting in concert with their fellow fiduciary and Trustee Mantell. As AmBase alleged, the three worked together, not alone, in misleading AmBase about the withholding tax obligation and in misinforming subsequent management about the Trust's liability for that obligation. *See* JA15. Therefore, it was only in 1996, after the last of the three collaborators left AmBase, that it was in a position to institute suit against its former fiduciaries.

AmBase acknowledges it has not discovered any New York decision applying the continuing relationship doctrine in the context of fiduciaries who are alleged to have collaborated in the fashion that AmBase asserts Scharffenberger, Pyne and Mantell did. However, the principles underlying the continuing relationship doctrine support its use in this case. As this Court observed in *Golden Pacific*, the reason for this doctrine "is that the beneficiary should be entitled to rely upon a fiduciary's skill without the necessity of interrupting a continuous relationship of trust and confidence by instituting suit." 273 F.3d at 519 (citing *Greene*, 451 N.Y.S.2d at 51). Under that rationale, AmBase should not have been require to interrupt "a continuous relationship of trust" and sue its three former fiduciaries who were acting in concert to the detriment of AmBase until the last of the fiduciaries had terminated his relationship with AmBase. In short, the relationship between the parties - that is, AmBase (on the one hand) and Mantell, Scharffenberger and, collectively (on the other) - did not terminate until 1996.

At a minimum, at this stage of the litigation, AmBase's allegations of concerted action and collective breaches of fiduciary duty should have been sufficient to allow AmBase to proceed forward with its claims against Scharffenberger and Pyne pending further development of the facts. *See, e.g., McCall*, 232 F.3d at 32-33 (requiring all facts to be construed in plaintiff's favor); *cf. Zenith Radio Corp. v. Hazeltine Research, Inc.*, 401 U. S. 321, 337-38 (1971).

Second, under New York's common law doctrine of equitable estoppel, "[a] defendant may be estopped from pleading the Statute of Limitations where a plaintiff was induced by fraud, misrepresentation, or deception to refrain from timely commencing an action." *Gleason v. Spota*, 599 N.Y.S.2d 297, 298-99 (2nd Dep't 1993) (citing, *inter alia*, *Simcuski v. Saeli*, 406 N.Y.S.2d 259, 262 (1978)). The doctrine is applied so "that a wrongdoer should not be able to take refuge behind the shield of his own wrong." *Gen. Stencils, Inc. v. Chiappa*, 272 N.Y.S.2d 337, 339 (1966). As this Court recently held in *Farkas v. Farkas*, 168 F.3d 638, 642 (2d Cir. 1999), to plead equitable estoppel, it is not necessary to allege that the defendant "actively thwarted" plaintiff's attempts to file a claim. Equitable estoppel can even be invoked when a lengthy period of time has elapsed between the time when a claim would ordinarily accrue and when the plaintiff alleges that it became aware of the claim. *See Will of Spewack*, 610 N.Y.S.2d 243, 245 (1st 1994) (failure to discover claim for 30 years after theft does not preclude use of equitable estoppel).

AmBase pleaded sufficient facts to enable it to avail itself of the equitable estoppel doctrine. *See Simcuski*, 406 N.Y.S.2d at 262.[23] Nonetheless, the District Court concluded

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[23] AmBase expressly alleged in its Complaint both that Scharffenberger and Pyne - as well as Mantell - misrepresented the nature

that AmBase should have discovered its claims against Scharffenberger and Pyne in 1996 when Mantell left.

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of the withholding tax obligation and that AmBase relied on the representations of these defendants in incurring the costs and expenses of defending against the withholding tax claim and in not bringing this lawsuit sooner. JA15. Moreover, the Complaint alleges that "[a]s they left the senior management of AmBase, each of the Individual Defendants perpetuated the misrepresentation that the alleged withholding tax liability was an AmBase obligation by advising subsequent management of AmBase that such alleged withholding tax liability was in fact the primary obligation of AmBase."